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# Harmonization of Sales Taxes

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# HARMONIZATION OF SALES TAXES

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# HARMONIZATION OF SALES TAXES*

## ISSUE DEFINITION

**On 23 April 1996, the federal government, Nova Scotia, New Brunswick and Newfoundland announced that they had signed a protocol of agreement on the harmonization of their respective sales taxes. The announcement was surprising, very few observers having predicted such an outcome. On 23 October 1996, the three provinces and the Government of Canada signed detailed agreements setting out the new harmonized sales tax system to be effective 1 April 1997.**

Attempts to harmonize the Goods and Services Tax (GST) and provincial sales taxes have seen many ups and downs over the years. **Only Quebec and the three Atlantic provinces have agreed to harmonize their provincial sales taxes. No other provinces are expected to join this very small group.**

**This paper examines the arguments in favour of having the provinces harmonize their respective sales taxes with the GST. The likelihood that more provinces will do so is also assessed.**

## BACKGROUND AND ANALYSIS

### A. Willingness to Harmonize Sales Taxes

On 20 June 1994, the Commons Finance Committee published its recommendations for replacing the GST. The report suggested introduction of a Canada-wide

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* The original version of this Current Issue Review, was published in August 1994; the paper has regularly been updated since that time.

value-added tax (VAT). Noting that integration of the federal and provincial sales taxes would solve the problem of the GST, the Committee pointed out that its proposal, in addition to simplifying collection of the tax for small businesses (through a business transfer tax), would make possible the full integration of the provincial and federal sales tax systems. A national VAT would include both a federal and a provincial component. It would be levied on the same base everywhere in the country except Alberta and would have a single set of standard rules. Because of the advantages of a national VAT (simplified system, reduced administration and compliance costs, less red tape thanks to the elimination of one whole level of government, economic benefits, etc.), the Committee thought that the provinces would be willing to harmonize their own sales taxes with the new national tax proposed.

This is not the first time that harmonization of federal and provincial sales taxes has been suggested. In 1966, the Royal Commission on Taxation (the Carter Commission) proposed replacing the federal manufacturers' sales tax (MST) with a national sales tax to be collected by the provinces. In 1983, the Federal Sales Tax Review Committee (the Goodman Committee) reported that the government was considering a federal value-added tax in whose administration the provinces would be invited to participate. In 1987, in its White Paper on tax reform, the government stated that tax reform provided "an opportunity for the federal government and those provinces choosing to participate to integrate their sales tax systems into a single national system."

Negotiations between Ottawa and the provinces on harmonization broke off in April 1989. The federal government at that point decided to defer the idea of a national tax and go ahead with the GST on its own.

In November 1989, in its report to the House on the technical paper on the GST, the Finance Committee recommended "that the federal government reiterate its support for a national sales tax and offer to establish the National Sales Tax on a partial basis as soon as three or four provinces, with a substantial population, are prepared to take part." Further on, the Committee recommended "that the federal government should begin developing plans, with the assistance of any interested provinces, for the creation and operation of a joint national sales tax collection agency."

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Before the Goods and Services Tax came into effect on 1 January 1991, all the provinces vigorously opposed its introduction and the idea of harmonizing it with their own respective retail sales taxes. They accused the federal government of encroaching on the area of consumption taxes, which they considered as falling within exclusively provincial jurisdiction. Moreover, it made sense for the provinces to avoid associating themselves with the federal government on the GST, given the political price that would have to be paid at election time for introducing such a very unpopular tax.

**However, a few months before the GST's introduction the provinces gradually seemed to abandon the arguments on which they had based their opposition.** In August 1990, the Quebec government and the federal government announced the signing of an agreement under which Ottawa would transfer to the province full responsibility for administration of the GST in Quebec.

By early 1991 they already seemed less reluctant to harmonize their respective sales taxes with the GST. Some of them sporadically gave out signals implying that they might be on the verge of reaching an agreement with Ottawa. In February 1991 the Saskatchewan government had said it would harmonize its sales tax with the GST starting in 1992. Up to the fall of 1991, even though the provinces' intentions continued to fluctuate, an apparent change of attitude suggested that most of them would have no choice but to join the movement to harmonization started by Quebec and Saskatchewan. **The NDP government elected in Saskatchewan in the fall of 1991 abandoned this plan, however.**

The climate took a sudden turn for the worse, however, at the end of 1991, and until late 1993, it was clear that the chances of harmonization were extremely slim. The October 1993 election of a federal government that promised to do away with the GST by 1 January 1996, the tabling of a report by the Standing House of Commons Committee on Finance and the resumption of federal-provincial negotiations on the question are important factors that have changed the dynamic of the debate.

At the end of June 1994, however, the federal government proposed a national VAT of 10%, with 4% going to the federal government and 6% going to the provincial

governments, together with a standard tax on income (of from 1.25 to 1.5%) to make up the shortfall in revenue. Subsequently, in August 1994, a VAT of 11% was proposed. In October 1994, Ottawa suggested a VAT of 12% (5% for the federal government and 7% for the provinces). In each case, the proposal was for one national sales tax, levied on the same base across the country, which would have been collected by the federal government. The provinces would no longer have had to spend the annual $300 million on collecting the provincial sales tax. Businesses would have seen their compliance costs substantially reduced, since they would no longer have had to deal with two tax authorities. In order not to put too great a strain on provincial revenues, the federal government planned to introduce sales tax credits for production inputs gradually over a period of four years.

The provinces opposed all these federal proposals. For some provinces, the loss of revenue following harmonization would be too great. In addition, harmonization would mean a transfer of companies' tax loads to consumers, an idea generally opposed by the provinces. The federal proposals were therefore simply rejected. From October 1994 until the end of 1995, there was no public movement with respect to harmonization.

Some believe that the election in Ontario in June 1995 of a Conservative government that had promised to harmonize the systems would be the catalyst for harmonizing sales taxes across Canada. However, in March 1996, Ontario announced that the province had been unable to reach an agreement with the federal government. One month later, the federal government backed off from its promise to eliminate the GST. At the beginning of 1996, the Prime Minister's advisers had reached the conclusion that the GST could not be replaced. Referring to an "error in good faith," the Department of Finance prepared to announce that the promise to eliminate the GST could not be kept.

On 23 October 1996, the federal government announced that it had signed an agreement with New Brunswick, Nova Scotia and Newfoundland to harmonize these provinces' sales taxes with the GST, effective 1 April 1997. The following table shows the combined rates in effect today and those that will be in effect on 1 April 1997 for each of the provinces.

Effective provincial sales tax and GST rates
(as a percentage)

| Province | Provincial tax in effect on **1 January 1997** | Combined Taxes Effective **1 January 1997** | Combined Taxes Effective 1 April 1997 |
|---|---|---|---|
| Newfoundland | 12 | 19.84 | 15 |
| Nova Scotia | 11 | 18.77 | 15 |
| New Brunswick | 11 | 18.77 | 15 |
| Prince Edward Island | 10 | 17.70 | 17.70 |
| Quebec | 6.5 | 13.955 | 13.955 |
| Ontario | 8 | 15 | 15 |
| Manitoba | 7 | 14 | 14 |
| Saskatchewan | 9 | 16 | 16 |
| Alberta | - | 7 | 7 |
| British Columbia | 7 | 14 | 14 |

In exchange for a uniform sales tax of 15% (14% for the provinces west of Quebec), the federal government has promised to compensate the eligible provinces. **It will pay them $961 million over a period of four years (that is, $349 million in each of the first two years, $175 million in the third year and $88 million in the fourth year) in order to make up for half of the loss in revenue from the sales tax in the three Atlantic provinces with which it has signed an agreement.** All the provinces west of the Maritimes are opposed to the compensation paid, considering it inequitable. **If all the provinces eligible for assistance (including Saskatchewan, Manitoba and Prince Edward Island) had signed the protocol of agreement on 23 April, the federal government would have paid a total of $1.5 billion in compensation.**

This "adjustment assistance" is based on a formula that applies to all Canadian provinces. It allows the provinces to be compensated for half of the loss in revenue from their own retail sales taxes, if this shortfall is greater than 5%. The assistance would cover 100% of the difference the first two years, 50% the third year, and 25% the fourth year. Under this formula, Quebec, Ontario and British Columbia would not see their revenues from their

respective sales taxes reduced by more than 5% under a harmonized system of 14% or 15%. As a result, they would not be entitled to any assistance if they agreed to harmonization.

Despite the federal agreement signed with three of the Atlantic provinces and with Quebec, the other provinces are still reluctant to accept harmonization. **No other province is expected to take this step in the near future.** They base their opposition on a variety of reasons, discussed below.

B. The Provinces' Reasons for Opposing Harmonization

Immediately after discussions on the GST ended in April 1989, the provinces began by invoking constitutional and political arguments to oppose what they saw as a federal *coup de force*. The Quebec government, for instance, immediately denounced the federal decision as unconstitutional, maintaining that a tax on goods and services represented flagrant interference in a field of taxation traditionally reserved for the provinces. It was generally conceded, however, that the federal government has unlimited tax powers and that it may use a method of taxation already used by the provinces. In June 1992, the Supreme Court confirmed that the GST was constitutional. This decision notwithstanding, the provinces continue to oppose harmonization for five reasons.

First, the provinces are hesitant to accept harmonization because this tax is politically very risky. It is obvious that by going ahead with harmonization and broadening their tax bases, the provinces would incur part of the political cost associated with the GST. This argument still serves to justify the opposition of the provinces today.

Second, by agreeing to harmonize their respective sales taxes with the federal system, the provinces would exempt business production inputs. Harmonization would therefore mean transferring the corporate tax burden to the consumer. As we shall see, this is still a major argument for several provinces.

Third, the provinces have always feared giving up significant discretionary powers over fiscal policy in a harmonized system. Since they could no longer set the tax base or rate in a harmonized system, they would lose any independence and flexibility with regard

to their respective retail sales taxes. In the 1996 agreement, however, the federal government is giving the provinces increased powers in the fields of individual and corporate taxation.

The fourth reason the provinces often cite for opposing harmonization is its administrative complexity. The federal government has often said that administrative simplicity and reduced compliance costs were important elements of a harmonized system. Because Quebec's administrative experience was not a success, however, none of the provinces felt compelled to believe federal claims. On the contrary, under the terms of the agreement announced in April 1996, the federal government, and not the provinces, will be responsible for collecting the tax. There is no doubt that a perfectly harmonized system would make tax collection easier. Compliance costs for businesses (particularly small businesses) would also generally be reduced. For some of them, however, a system that differed from region to region would lead to difficulties and an increase in compliance costs. In fact, the experts have often said that if the effective rates and the bases varied between regions, the tax treatment of interprovincial transactions would be complex. Under the agreement signed, interprovincial transactions not confined to the harmonized provinces will be more complex because the tax bases and effective rates will be different from one transaction to another, depending on the province concerned.

Finally, the provinces have always refused to harmonize their systems, claiming that to do so would lead to lost revenue and budgetary problems. Even with a broader base, several provinces would face a decrease in revenue because of having to reimburse production input taxes. In order to counter this argument, the federal government is promising to compensate the provinces through its adjustment assistance program. In addition, as we have already pointed out, the federal government is granting the provinces that have signed agreements increased authority in the fields of individual and corporate taxes. Taken together, these measures should help the provinces that have moved to harmonization to make up for the shortfall in their revenues.

## C. Current Provincial Positions

This section will look at the position of each of the provinces on harmonization of their respective provincial sales taxes with the federal tax.

1. New Brunswick, Nova Scotia and Newfoundland

Until mid-1994, the official response to harmonization in these three provinces was always negative. Despite its opposition, however, Newfoundland announced in December 1990 that its taxation base would be adjusted to improve harmonization with the GST. In July 1993, New Brunswick adjusted the portion of its taxation base involving goods in order to achieve partial harmonization with the GST taxation base, thereby enabling its sales tax to be collected by customs officers. In June 1994, the three provinces approved the federal proposal for a national VAT. In June 1995, the Nova Scotia Minister of Finance said that he would like to see a national sales tax with regionally varying rates.

On 23 October 1996, these three provincial governments announced that they had signed an agreement with the federal government. **The harmonized sales tax (HST) will replace the retail sales tax and the GST on 1 April 1997. The HST will have a single rate of 15%: seven percentage points represent the federal component, and eight percentage points represent the provincial component. The HST will follow the same basic operating rules as the GST and will apply to the same tax base of goods and services (with the exception of books, which will not be subject to the 8% provincial portion of the HST). If a non-participating province were to sign the agreement and thereby bring the total provincial tax base to more than 50% of the GST tax base, the federal government, the province that had signed the agreement most recently and the provinces that were already parties to the agreement would meet to negotiate changes to the harmonized tax base in light of the extended participation.**

**In addition, participating provinces must unanimously approve any change to the tax base that would reduce their revenue by more than 1%. Conversely, should a participating province oppose a change proposed by the federal government (taxing food, for example) that would increase revenues by more than 1%, the change could not be implemented unless Revenue Canada administered free of charge a rebate of the provincial component or a point-of-sale rebate.** The agreement provides for a provincial sales tax of 8% for four years (from 1 April 1997 to 31 March 2001). After that date, the

provinces agree only to maintain a common regional rate. **Moreover, the federal and provincial components of the HST can be increased by only one-half of 1% at a time. The difference between the two components may never be more than one percentage point, and the federal component of the HST - that is, the GST - must never be higher than the provincial component.**

The HST will be included in the advertised price of goods. The exact amount going towards sales taxes will appear on the cash register receipt. Revenue Canada will be responsible for administering the new tax.

To compensate the provinces whose revenue from retail sales taxes will drop, the government will pay the three provinces $961 million. **In addition, according to the April 1996 protocol of agreement, in order to compensate all the provinces for their loss of independence with respect to sales taxes and for their lost revenues, the federal government will allow them increased flexibility in the fields of individual income tax (it will administer a uniform individual income tax at no cost to the provinces) and corporate tax.** The federal government will allow provincial taxes to be deducted from payroll expenditures and capital in calculating the federal tax on corporate earnings, but it will also administer a tax on corporate earnings for the provinces.

**Registrants in non-harmonized provinces will be responsible for collecting and remitting the HST on goods and services they sell to the harmonized provinces. On the other hand, when selling goods or services to customers in non-harmonized provinces, the registered supplier in a harmonized province will not have to collect the provincial portion of the HST.**

New Brunswick claims that the agreement will cost it $170 million annually, or the amount of revenues from production inputs. In order to offset this loss, the federal government will pay the province $364 million over four years. The provincial premier has admitted that new corporate taxes will be introduced in order to pay for part of the cost of harmonization. **Details of the new taxes are still not known. According to the December 1996 budget, the new taxes will have minimal impact, since they will affect only 5% of firms (about 900 companies).** The provincial government claims that the annual savings for a family of four will be $75 if its income is $10,000, $146 if it is between $10,000 and

$30,000, $277 if it is between $30,000 and $50,000, and $471 if it is over $50,000. In addition, the government maintains that between 6,000 and 12,000 jobs will be created in the province as a result of the agreement. The provincial GDP is expected to increase by between 0.5 and 1% each year. On 7 June, the Minister of Finance declared: "The government of New Brunswick will only sign a formal, detailed arrangement for tax harmonization if it clearly benefits the people of this province, stimulates the economy and creates jobs."

In Nova Scotia, harmonization will cost the government $120 million annually. The federal government will pay the province $249 million in compensation. The provincial government claims that 3,000 jobs will be created by harmonizing the two systems. On 17 May 1996, it announced that harmonization would produce annual savings of $128 for the average family earning between $30,000 and $50,000 a year, and $179 for a family earning between $50,000 and $80,000. On average, the savings for households should work out to $114 a year. The government estimates that businesses will pass on the benefits to consumers, in the form of half of the savings generated by the non-taxation of inputs. In addition, in order to make up the shortfall, the government will introduce, effective 1 April 1997, a capital tax of 0.25 % applying to businesses holding over $10 million in capital (it will be introduced gradually for those with between $5 million and $10 million in capital). It is estimated that 1,000 business will be affected by this measure, which will bring the government approximately $45 million in taxes annually.

Harmonization of the systems will mean a loss of $105 million for Newfoundland. The federal government will pay the province $348 million over a four-year period.

In all three provinces, aside from a few complaints, taxpayers and the business sector have reacted quite well to the agreement. Premier McKenna said: "I think the fact that the rest of Canada is so critical now of the amount of money that is flowing into Atlantic Canada, that should be the proof that this is really a good deal for Atlantic Canada." **Consumers have criticized the impact that harmonization of the systems will have on the price of new houses (although Nova Scotia will be giving a partial rebate of the provincial**

component to home buyers), gas and heating. Also in Nova Scotia, the expected negative impact of harmonization on municipalities, educational institutions and hospitals was criticized. Those who reacted most negatively to the agreement were the national advertisers and large retail chains, who pointed out the problems they will encounter because of tax-inclusive pricing. National retail chains cannot easily administer a partially harmonized, multiple-rate system - that is, one that varies from region to region; their computer systems will require costly retooling. National advertisers will have to change television advertisements and print new advertising inserts and catalogues. As well, their inventory management and product distribution will be more expensive. In addition, certain products (such as magazines and greeting cards) are labelled in advance but some retailers will have to ticket items individually in order to comply with the legislation.

2. Prince Edward Island

In April 1992, Charlottetown announced that the province would harmonize its sales tax with the GST. In August of the same year, the government reversed its position. It then indicated that it needed to consider the matter further. Since June 1994, provincial authorities have been looking seriously at the possibility of agreeing to a national tax.

Despite the fact that its three neighbouring provinces have signed the protocol of agreement, Prince Edward Island is still holding out. One month before the announcement of that agreement, however, P.E.I.'s Finance Minister had said that it would be difficult not to agree to harmonize if other provinces such as New Brunswick and Nova Scotia agreed to do so.

On 23 April 1996, the provincial government announced that it wished to examine in greater depth the consequences of harmonization for the province's revenues, before going ahead. The federal government is ready to pay $60 million over four years in order to compensate the province for the loss of $30 million in revenue per year. Political

leaders agree that compensation of $60 million is not enough. On 25 April, the Premier said that the province was expecting to receive more.

**The fall 1996 provincial election upset plans for sales tax harmonization. During the election campaign, the three main political parties in the province all rejected the idea of harmonizing the two taxes. The negative conclusions drawn by a provincial commission set up to examine this issue and the election of a Conservative government in November 1996 ended any plans for harmonization; however, it will be difficult for the government to hold out for long against the undeniable advantages of harmonization.** Island businesses will soon be complaining if the government turns down the proposal.

3. Quebec

Despite the fact that Quebec refused to reach an agreement with Ottawa, it is the Canadian province that has harmonized its sales tax most closely with the GST. The anticipated administrative advantages have not been realized, however. It was expected that fewer than 500 employees would be needed to administer both taxes; in December 1992, Quebec admitted that administering the GST and the TVQ had cost $100 million and necessitated the hiring of 1,400 civil servants. Each year, the federal government pays out several tens of millions of dollars in order to compensate Quebec for collecting the GST. In 1996-97, the amount will be $92,750 million (it was $94.4 million in 1995-96 and $75.2 million in 1994-95). **Furthermore, because the principles of application have been different for each tax for a long time, harmonization did not make life easier for businesses.** The most significant difference was that until very recently the Quebec tax was not a multi-stage tax. Quebec avoided such a tax because of constitutional considerations; it believed that it was unconstitutional for a province to levy taxes at different levels of production. On 23 June 1994, the Supreme Court ruled in a declaratory judgement that the provinces would not exceed their constitutional powers by levying a multi-stage tax like the GST, where the tax burden falls legally on the consumer.

Quebec reacted rather badly to the Finance Committee's report and to the original proposal to introduce a 10% national VAT. In the first place, the then Liberal government felt that the introduction of a national tax would pose some major challenges, particularly if each government were to maintain its political and fiscal autonomy.

With the election of the Parti Québécois, all discussions on the complete harmonization of sales tax were back to square one. A number of observers felt that Ottawa had just lost a major ally in the debate. In fact, the new government in Quebec said it would prefer to have full jurisdiction over all taxation matters, with Ottawa no longer collecting the GST in Quebec and reducing its transfers.

Accordingly, the announcement in the May 1995 budget that phase 2 of the harmonization of both sales taxes would go ahead came as a surprise. Since 1 August 1995, the QST has become a genuine value-added tax, which will be applied uniformly at every stage of the production process; moreover, businesses are refunded the QST they pay on their purchases. Since 1 August 1995, only small businesses have been entitled to a full refund. Large companies will not be eligible for a full refund until 31 March 1997 (four months later than the date announced in 1995. **The government announced in December 1996 that municipalities would no longer be entitled to the partial QST rebate. The municipalities reacted negatively to the news, which will mean a shortfall of $75 million for them.**

Initially, Quebec's reaction to the announcement of a national VAT in three of the Atlantic provinces was very positive. On 23 April 1996, the Ministre d'État à l'Économie et aux Finances said that it was a very good thing and that with a VAT everywhere else, Quebec's tax had the advantage of being lower, placing the province in a competitive position. On 20 May 1996, the Government of Quebec nonetheless demanded financial assistance of $1.9 billion from the federal government in compensation for harmonizing its tax in 1991. The following day, the Finance Minister of Canada said that under the formula being used Quebec was not entitled to adjustment assistance; furthermore, because Quebec had introduced harmonization over a period of six years, it had been able to put measures in place to generate

supplementary revenues. At most, the province would have lost $35 million if it had suddenly decided to harmonize its sales tax with that of the federal government.

Quebec denounced the compensation formula on the grounds that it was designed to benefit the provinces with very high sales taxes. It then argued that it had taken so long to merge the systems precisely because complete harmonization meant significant tax losses for Quebec. In order to offset its loss of revenue, the provincial government said that it had had to increase income taxes, as well as capital and payroll taxes. **On 13 December 1996, the federal government finally reacted to all these arguments, claiming that Quebec had had no tax loss and that, by partially harmonizing the QST with the GST, Quebec had derived higher tax revenues. According to the federal government, even if Quebec had gone ahead with full harmonization, the province would not have been entitled to adjustment assistance.**

4. Ontario

After claiming that the GST was unconstitutional, in February 1992 Ontario agreed to examine the federal proposal seriously. A number of observers thought that Quebec's decision to harmonize its sales tax with the GST would force Ontario to do the same. But when administering the Quebec tax proved to be extremely expensive, this did not happen. In its final report, published in December 1993, Ontario's Fair Tax Commission revived the discussion by proposing harmonization of the provincial retail sales tax with the GST. The Commission maintained that removing the tax from business inputs would increase capital investment by from 2 to 4% and non-residential construction by from 1 to 3%. The Commission proposed that the Ontario government might broaden its tax base to include, for example, prepared food items purchased in stores (e.g. frozen meals) and financial services.

Just before the new government was elected in June 1995, Ontario still opposed harmonization and even the most recent proposal for a national 12% VAT. On 26 September 1994, Ontario's Minister of Finance proposed to Ottawa that Ontario and the federal government exchange taxation fields (the proposal is commonly referred to as the 0% option).

Ontario would give up its provincial sales tax in exchange for greater control over and a greater share of income tax, while Ottawa would replace the 7% GST with a 15% VAT. With more control over income tax, Ontario would be able to recover $7 billion from what had gone to the federal government. Ontario's share of income tax would increase; the federal government's share would decrease. Although it was discussed by a number of provinces, the proposal was never implemented. A number of commentators had thought that the election of a Conservative provincial government promising to harmonize the two systems might have provided the necessary momentum for national harmonization.

In fact, until early 1996, the province and the federal government were holding serious discussions. On 10 January 1996, during a trip to Bombay, the Premier of Ontario reported that his province and the federal government were very close to an agreement. The Ontario Finance Minister added, however, that harmonization must not add to the tax burden of Ontarians. A complete merging of the systems would result in a transfer of the corporate tax burden, estimated at $2 to $3 billion, to Ontario consumers.

On 10 March 1996, the government announced that it was rejecting the federal proposal of a 14% VAT. The province claimed that the average family with an income of $30,000 to $40,000 would pay $185 more in sales tax under a harmonized system. The provincial government made an offer to the federal government for harmonization of the systems using the tax base already in effect in Ontario, rather than the GST tax base.

Ontario did not react well to the transfer of $961 million to the three Atlantic provinces, alleging that 41% of the amount paid to them would come out of Ontarians' pockets. On 1 May 1996, the Minister of Finance demanded that the GST applicable in Ontario be reduced to 5.5%.

Ontario is now waiting for a new offer from the federal government. The odds are high that it will be a long time before Ontario and Ottawa resume discussions.

5. Manitoba

Once Saskatchewan dropped the ides of harmonizing its sales tax with the GST, the pressure on Manitoba lessened appreciably. In February 1992, the Manitoba government did imply that it might well reach an agreement with Ottawa. But the only agreement it has signed involved partial harmonization of its tax base (excluding clothes, shoes and books); as a result, provincial sales tax has been collected by federal customs officers since July 1993. The provincial government remains opposed to the idea of a national VAT on the grounds that the loss in revenue and the impact on consumers would be too great.

The government's reaction to the announcement that a protocol of agreement had been signed with three of the Atlantic provinces on 23 April 1996 should therefore come as no surprise. It is not known how much the federal government offered Manitoba in the way of financial compensation. Since over 40% of sales taxes revenues come from the taxation of production inputs, the harmonization proposed by Ottawa would mean a transfer of over $300 million of the corporate tax burden to consumers. The provincial government still believes that Manitobans would derive no benefit from such an agreement. At the beginning of June, the provincial Premier said that taxation would have to be reviewed in order to avoid similar inequitable agreements giving special treatment to certain regions.

6. Saskatchewan

Ever since October 1991, when it reversed its decision to harmonize its provincial sales tax with the GST, Saskatchewan has advanced the same arguments. It sees harmonization as just one of many pieces in the fiscal jigsaw puzzle. Its government considers that harmonization must be seen as part of a whole, and not as something that can be negotiated in isolation from other tax-related questions (reform of social security, personal and corporate income tax, etc.). The Saskatchewan government also considers that harmonization would neutralize the independence that the provinces currently enjoy. Lastly, it is concerned by the fact that consumers would have to carry a heavier tax burden, since in a harmonized system businesses would no longer have to pay sales taxes on inputs.

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The Saskatchewan government therefore turned down the offer of a 14% VAT. Despite the compensation offered by Ottawa (the amount of which has not been made public), the provincial government would have been forced to increase other taxes in order to make up for the drop in its revenue. In addition, harmonization would mean a transfer of over $400 million from businesses to consumers. The Premier of Saskatchewan is also proposing an in-depth review of taxation in order to avoid similar fiscal agreements whereby the provinces are pitted against each other.

7. Alberta

Like its voters, the government of Alberta is still vigorously opposed to any sales tax. It even took the constitutionality of the GST to the Supreme Court, claiming that the tax infringed provincial jurisdiction and violated provincial fiscal immunity by taxing health-care establishments, schools, colleges, universities and municipalities. Alberta considers that Ottawa should cut spending and eliminate the GST, rather than digging ever deeper into the taxpayer's pocket by adopting a national sales tax of 12%.

The provincial government vigorously opposed the announcement of agreements with three of the Atlantic provinces. The Premier said that $1 billion did not just appear out of nowhere. The province also demanded that the GST in Alberta be lowered to 5.5% in order to compensate consumers. Such a reduction would save consumers in that province $485 million annually.

8. British Columbia

British Columbia has always refused to harmonize its sales tax with the GST. In June 1994, its government opposed the idea of a national 10% VAT. The provincial Minister of Finance said that, as far as she could see, harmonization would shift the burden of corporate taxes (currently about $1.2 billion provincially) entirely on to the consumer and the savings resulting from elimination of the tax on production inputs would not translate into a reduction in prices to consumers. The Minister went further: she called for a review of the

whole question of division of taxes between the two levels of government. The provincial government maintained that, while the federal government was withdrawing more and more from financial commitments, the provinces needed stable and reliable sources of revenue for health care, social services and education. In September 1994, British Columbia said it was prepared to give up its provincial sales tax in exchange for greater control over income tax, as had been suggested by Ontario.

It therefore came as no surprise that the province opposed the agreement announced on 23 April 1996. According to provincial authorities, the agreement would mean a $400 increase in taxes for an average family in British Columbia. The federal government maintains, however, that the province would take in $240 million more in taxes. The provincial government is opposed to any increase in the tax burden of consumers. It is estimated in Victoria that such an agreement would lighten the tax load of businesses by $1 billion, which would then be passed on to consumers.

## CONCLUSION

A little more than one year ago, it was thought that Ontario would harmonize its sales tax with that of the federal government. Several other provinces would probably have followed this lead.

The situation today is much changed. First, the announcement that an agreement had been signed between the federal government and only three of the Atlantic provinces has significantly changed the dynamics of the debate. **It seems that Prince Edward Island, Ontario and all the western provinces will maintain their position and refuse to ratify agreements similar to those signed on 23 October 1996. The hoped-for momentum has not materialized.**

However, the federal government will not deviate from its position. **Clearly, then, the idea of a national, single-rate sales tax in effect throughout Canada can be forgotten. The most the federal government can hope is that, one day in the far-off**

**future, there will be six variable-rate regional sales taxes (in British Columbia, Alberta and the Territories, Saskatchewan and Manitoba, Ontario, Quebec, and the Atlantic provinces). While the federal government is proud of having signed agreements with three of the Atlantic provinces, all is not rosy for it either. By signing such agreements, Ottawa has, in a way, been caught in its own trap; it will not easily be able to change the proposal in order to satisfy those provinces still refusing to sign, without endangering the administrative benefits of the harmonized system.** For administrative simplicity, the same rules should apply throughout the country. The formula for adjustment assistance and tax bases could not be made different in eastern and western Canada, for example. For administrative simplicity, the same rules should apply throughout the country.

The introduction of the harmonized GST on 1 April 1997 will not be smooth. Many consumers will undoubtedly postpone buying certain goods (such as automobiles) until then in order to take advantage of the reduced tax. Conversely, many other consumers will hasten to make certain purchases (for example, new homes and children's clothing) in order to avoid the new tax. A number of observers will be keeping a close eye on the transition period in order to see if companies do pass on to consumers the refund of taxes on production inputs.

Already, a number of groups defending the interests of Canadian companies are beginning to complain about the regional nature of the agreement. For businesses, harmonization implemented in only four provinces will further complicate many aspects of interprovincial trade. **Companies across Canada will have to collect the HST on goods and services they send to the three newly participating provinces.**

The inclusion of the HST in advertised prices will be expensive for businesses. National advertisers will have to change their advertising (which will be a complex undertaking in the case of catalogues, inserts and television messages). The labelling of products for which prices have been already set will pose problems. Once again, companies will have to reprogram cash registers.

**It is interesting to note that the federal government is preparing to compel companies across Canada over which it has regulatory authority to use tax-inclusive**

pricing. Despite these measures aimed at reducing its visibility, the tax will be costly from the political standpoint, since consumers will be paying a tax they continue to find odious, with the added complication that they will not know whether or not a price includes GST.

For individuals and companies, harmonization could eventually mean increased taxes. Already, Nova Scotia and New Brunswick have announced new taxes on corporate capital. Effective 2001, when federal assistance ends, the three provinces could be forced to increase the provincial HST component of 8% in order to cover the shortfall in revenue.

Finally, accounting irregularities have still to be clarified. In March 1996, the federal government agreed to give the three newly participating provinces transition assistance, payable on signature of the agreement. Despite the fact that the HST will not come into effect until 1 April 1997, the adjustment assistance was paid on 1 October 1996. Parliamentarians must ask themselves whether making such a premature payment was justified.

In addition, the transition assistance of $961 million was reported as a liability at 31 March 1996 and was charged to expenditures, which resulted in a concomitant increase in the deficit for 1995-1996. The federal legislation authorizing transition assistance was tabled in Parliament on the same day as the agreement in principle was announced: 23 April 1996. Debts to third parties are normally reported as liabilities when the event that produced the debt occurred before or at the end of the fiscal year. In other words, since the agreement was signed after 31 March 1996, the compensation should not have been entered in the accounts at that point in time.

In his observations on the financial accounts of the Government of Canada, published in the Public Accounts 1995-1996, the Auditor General wrote that, even though the government had committed itself to compensating the provinces, it did not have to pay the compensation before the agreements were signed. On 31 March 1996, the transition assistance constituted a commitment and not an amount payable. The government argued that the inclusion was in line with standard accounting practice

**because the MOUs had been sent to the three provinces before 28 March 1996 and all the parties had agreed on the harmonization principles contained in the documents. The government felt it was proper to record the commitment as a liability for 1995-1996. Parliamentarians must ask themselves whether the accounting rules governing the public sector have been respected.**

## PARLIAMENTARY ACTION

Bill C-62, passed in December 1990, gave rise to the Goods and Services Tax and prompted an acrimonious debate in the Senate. Clause 64 of Bill C-31 provides for the payment of $961 million to three of the Atlantic provinces. **Bill C-70 establishes the legal framework for the sales tax harmonization agreements.**

In December 1990, Quebec's National Assembly amended the *Loi concernant l'impôt sur la vente au détail*, harmonizing the provincial sales tax with the GST in the process.

New Brunswick, Nova Scotia and Newfoundland will have to amend the legislation governing their respective provincial sales taxes.

## CHRONOLOGY

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| 18 June 1987 - | White paper on tax reform. |
| 24 April 1989 - | Negotiations between Ottawa and the provinces on harmonization of the provincial sales taxes and the future federal sales tax were broken off. The Government of Canada abandoned the idea of a national sales tax and decided to act unilaterally. |
| 8 August 1989 - | Technical paper on the GST. |
| Winter 1990 - | Adoption by the House of Commons of Bill C-62. |
| 30 August 1990 - | Quebec announced its intention to harmonize its sales tax with the GST. |

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| Fall 1990 - | Senate debate on the GST. |
| 14 December 1990 - | The Quebec National Assembly adopted amendments to the *Loi concernant l'impôt sur la vente au détail* to include provisions applicable to Quebec as of 1 January 1991. |
| 19 December 1990 - | Newfoundland adjusted its tax base. |
| 21 December 1990 - | A reciprocal taxation agreement on implementation methods was signed by Ottawa and Quebec. |
| 1 January 1991 - | The GST came into effect in Canada, as did phase one of the new harmonized provincial sales tax in Quebec. |
| 20 February 1991 - | Saskatchewan announced that it would harmonize its provincial sales tax with the GST. |
| 1 April 1991 - | Phase one of harmonization of the Saskatchewan sales tax with the GST came into effect. |
| 9 April 1991 - | Plans to harmonize the sales tax with the GST were unveiled in the Prince Edward Island budget. |
| 8 August 1991 - | The government of Prince Edward Island announced that the harmonization of the provincial sales tax with the GST would not take place. |
| 22 August 1991 - | The government of Nova Scotia announced that it would not be harmonizing its provincial sales tax with the GST. |
| 22 October 1991 - | Return to the tax treatment provisions in existence in Saskatchewan prior to 1 April 1991. |
| 24 October 1991 - | Quebec postponed the introduction of its tax on services until 1 July 1992. |
| 14 May 1992 - | The government of Quebec announced that a 4% sales tax would apply to services. |
| June 1992 - | The Supreme Court ruled that the GST was constitutional. |

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1 July 1992 - The second stage of sales tax reform came into effect in Quebec.

1 July 1993 - After New Brunswick and Manitoba had partially harmonized their taxation base with the GST, Revenue Canada began to collect provincial sales taxes for these provinces at the border.

20 June 1994 - The House of Commons Standing Committee on Finance tabled its report on the GST.

23 June 1994 - In a declaratory judgment, the Supreme Court ruled in favour of Quebec and granted the provinces the right to introduce a multi-stage tax such as the GST.

29 June 1994 - The federal government called for the introduction of a 10% national VAT.

August 1994 - Ottawa proposed a VAT of 11%.

September 1994 - Ontario proposed to Ottawa that the province would give up its provincial sales tax in exchange for greater control over income tax (British Columbia and Manitoba support this proposal).

13 October 1994 - The federal government proposed a VAT of 12%.

9 May 1995 - Quebec announced that the QST would be fully harmonized with the GST.

23 April 1996 - The federal government and the governments of Nova Scotia, New Brunswick and Newfoundland signed a protocol of agreement to harmonize federal and provincial sales taxes. The federal government is paying $961 million in compensation to the provinces.

**23 October 1996 - Three Atlantic provinces signed detailed agreements setting out the new harmonized sales tax system to be effective 1 April 1997.**

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